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INTERVIVOS AND TESTAMENTARY TRUSTS

STANLEY H. JOHNSON
of the Denver Bar

This article is intended to present in abbreviated form the substance of a lecture before Denver lawyers and others in a seminar concerning estate planning upon the subjects of living and testamentary trusts. It is intended to present briefly the various types of trusts, some of the advantages and disadvantages of each, some of the pitfalls to be avoided, and some desirable provisions that should be included.

By living trusts are meant those transactions where legal title to property, and usually possession, are transferred to a trustee during the lifetime of the creator of the trust, the creator being commonly called the settlor or grantor. Three forms of such trusts are presently in common usage: insurance trust agreements, intended to provide for the distribution by the trustee of the proceeds of life insurance after the settlor's death; declarations of trust, in which property in the hands of the settlor is formally set up in trust with the settlor and possibly others as trustee or trustees, sometimes with provisions concerning the trusteeship and disposition of the property after the settlor-trustee's death, and sometimes without; and the ordinary living or intervivos trust agreements, which usually have a testamentary disposition. They will be discussed in that order.

Such agreements are usually made as a part of an estate plan to provide ready cash to the executor for administration expenses and taxes by way of a loan from the trustee on terms within the trustee's discretion, that is, with very low interest rates or

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EDITOR'S NOTE: During the past several years, the subject of estate planning has gained the increasing attention not only of attorneys but also of trust officers, certified public accountants, and life underwriters. In an attempt to gain greater understanding of some of the difficult legal problems involved in estate planning as well as the role which could be played by representatives in each of these fields, the Fourth Annual Law Institute, jointly sponsored by the University of Denver College of Law and the Junior Bar Sections of the Colorado and Denver Bar Associations, was devoted to the general subject of estate planning and was presented in Denver during April and May of this year with the cooperation of the Rocky Mountain Chapter of the American Society of Chartered Life Underwriters. Both attorneys and life underwriters addressed the institute.

The articles contained in this issue of DICTA are adaptations of some of the lectures delivered at that institute. Unfortunately, space limitations make it impossible to publish here all the lectures there presented; consequently, several excellent addresses from that institute are being held for publication in subsequent issues of DICTA.

none at all, and with testamentary disposition as to the proceeds in trust for family usage. Provision may be made in such agreements for the additional transfer of other property from time to time, such as securities or real estate, which may be desirable to include in the trust. Except in unusual circumstances, such agreements are always made subject to amendment and revocation, and the settlor reserves all of his original rights under the policies until his death.

Some of the advantages are: the flexibility of use of income and principal by the trustee over and above the options provided in the policies, and under the present interest and dividend rates, a chance to earn more money (through sound investment by a bank as trustee) than can be earned in the ordinary policy recently issued; such portions of the principal of the trust as may be necessary for the executor's use in paying taxes and expenses is made readily available without losing the $75,000 exemption under Colorado Inheritance Tax Laws for insurance payable to beneficiaries; if the trustee's duty is merely to hold the policies until the settlor's death and then collect and distribute proceeds, no trustee's fee is ordinarily charged until the settlor is dead; of course, the availability of ready cash to the executor means that estate property need not be sold by him at an unfavorable time and that money may be available to carry on a business of the settlor until such time as it can be wound up under favorable conditions.

The current annual bank fees, of recent adoption, upon all forms of living or testamentary trusts of which the assets are made up of securities and cash, are about as follows:

	Fee
$5 per $1000 of principal value for the first $50,000	$250
$4 per $1000 for the next $50,000	$200
$3 per $1000 for the next $100,000	$300
$2.50 per $1000 for the remainder.	

A distribution fee for distributing principal is charged at the rate of 2% for the first $50,000 and 1% for the balance. This would be applicable to invasions of the principal for the benefit of a widow or children.

It would probably be better in drawing such an agreement not to refer expressly to loans by the trustee to the executor, because the Inheritance Tax Commissioner might claim that the agreement was a subterfuge to evade taxes, but a general provision for full discretion in making loans by the trustee is of course sufficient. One of the greatest advantages is the flexibility of the insurance trust agreement, which permits a trustee, for example, to distribute income or principal for the education of children in accordance with their needs of the moment instead of treating each equally, and also paying out for emergency and medical care, and the like.

The disadvantages of the insurance trust agreement are: first, the additional cost of a trustee's fee, now somewhat higher than formerly, which is not present in insurance options (of course it may be avoided by using individual trustees in the family which will not charge a fee, but investment judgment and permanency of the trustee may be lacking) ; and second, the loss of settlement options, since the more recent insurance policies provide that none of the options shall be available to a corporate trustee, but under the low earnings of most recent insurance policies, this disadvantage is offset by the greater earning of a diversified investment program.

Except that the trustee is dealing with insurance proceeds, the provisions of an insurance trust agreement concerning the powers of a trustee and distribution are similar to those in the ordinary living trust agreement and will be discussed under that heading.

Declarations of Trust

Lawyers generally seem not to be so familiar with declarations of trust, which may be utilized (1) to explain the uses under which property is held by the declarer of the trust, where the title is held by him as nominee without disclosing the trust, and also (2) for situations where property is held in joint tenancy and one or more of the joint tenants actually has no equitable interest in the property but is holding it for the purpose of management or distribution—actually as a trustee. It is also useful for making a gift enforceable. In other words, a promise to give property or money to another is unenforceable, but if set forth in a formal declaration of trust with a transfer by the owner to himself or another as trustee, the gift becomes complete, unless the declarer reserves the right to revoke it.

A declaration of trust is of course not ordinarily an agreement with any person but rather a recitation in an instrument which may be in form and effect a deed, stating the uses for which the property is held, providing for a successor trustee in the event of the death of the settlor-trustee, and making provision for final distribution. An individual commonly holds title to property—which he does not actually own, except for the record or obvious title—under constructive or resulting trusts, or under an oral trust agreement. If the party conveying the property under an oral agreement in trust is dead or has no capacity to execute a trust agreement, the person holding the title may publish to the world and to the executor of his estate the actual circumstances under which he holds the property, by an instrument in writing called a declaration or a deed of trust. It is rather common to find that a mother who has reached old age and may become senile has placed property in her own name and that of one of her children in joint tenancy, under an oral agreement that the child, upon the mother's death, shall dispose of the property for the child's own benefit and also for others. Where this situation exists, it may be desirable that the child establish by a declaration of trust exactly what the terms of the oral agreement were. This may even include provisions for disposition of the property upon the death of the child in accordance with the oral agreement, and for a successor trustee. Possibly such declaration might be subject to attack by an interested relative who is not included among the beneficiaries, but ordinarily the powers of the child to name a successor-trustee and to set forth the distributive provisions, following the child's death, would not be challenged.

The advantages of the declaration of trust are: the difficulty of proving the nature of the trust by the child's executor, in the event of the child's death, is avoided; also eliminated is the cost of appointing a new trustee in the district court; and the nature of the trust is defined in writing.

Some caution should be exercised in determining whether any gift taxes should be declared and paid, and this will involve knowlege of previous gifts of the original donor.

LIVING OR INTERVIVOS TRUST AGREEMENTS

The provisions of such agreements are usually applicable also to insurance trust agreements and declarations of trust. Living trust agreements are sometimes made without testamentary disposition, any residue after the death of the settlor pouring into the settlor's estate, but this results in unnecessary administration expense and fees. Usually, however, provision is made for distribution of the property after the settlor's death, where the settlor has died without revoking the trust agreement. Such trust agreements should only be made irrevocable where the settlor is prepared to surrender all interest in the property, and this is usually done for the purpose of establishing a present gift. Even where the trust is made irrevocable as a gift to minors, if they do not get the present benefit of the income or principal, theirs is a future interest and not available for the annual gift tax exclusion, though qualifying for the gift tax exemption. The advantage of such a trust for minors is that it avoids the expense and nuisance of a guardianship, or, where one of the beneficiaries may become mentally or physically incompetent, of a conservator.

As in a will, real estate may be set up in trust for the benefit of many persons with provisions, in the case of a residence, for use by various members of the family, without having the title vest in a member of the family who already has a substantially taxable estate. It is also useful, where many persons, who would otherwise be co-owners, are buying real estate, to place the title in the hands of two persons as joint tenants who are actually co-trustees. If this device is used, a partnership or corporation with all of the accounting and tax problems, may be avoided, but nevertheless the trustees must of course report the distribution of income on the usual fiduciary tax form. Such agreements are also used occasionally for trusts to vote the stock of family corporations, but in drawing such agreements a reference should be made to the Colorado Statute on Voting Trusts, Vol. II, Colo. Stat. Ann., chap. 41, sec. 45. See also an article in Vol. XII, DICTA, No. 6, by Shippey.

Except in the East, where living trusts were formerly in rather common use even by business men during their lifetimes, the living trust agreement is ordinarily desirable for such persons as widows who have no investment judgment, or those who desire to provide for spouses, or minor children, during their lifetimes, for professional and other men who have substantial incomes but are not educated in investments, and for elderly people who may become senile and desire to protect themselves against incapacity. The living trust agreement has the advantage of not being so readily subject to attack as a will, because it is set up while the settlor is still living with many witnesses who may substantiate his competency. It is useful also with ante-nuptial agreements, or where a husband or wife have become estranged, in order to place the title and management of property in the hands of a trustee in accordance with the desires of the settlor.

There has never been a determination in Colorado as to the rights of the wife to elect to take half of an estate set up by a husband in trust against her interests, although an Illinois decision set aside such a trust, as an attempt to evade the wife's right to elect to take a portion of the husband's estate. The Colorado statute on election is restricted to wills and estates, and where a settlor, for example, is providing for his children by a previous marriage, it is quite possible that the court would not permit the wife to invade the trust created by the settlor for such a worthy purpose during his lifetime. This would be particularly true under an ante-nuptial agreement entered into between husband and wife permitting the husband to dispose of some or all of his property for the benefit of his children by a prior marriage. The chief advantage of the living trust is of course the avoidance of the waste of time, money, and trouble of probate or administration proceedings in court.

There are some drafting problems in connection with living trust agreements. Care should be exercised as to what portion of estate, inheritance, and income taxes are to be paid from the trust estate, and whether such payments should be made from income or principal, or both. The draftsman should decide whether the trust fund should pay for such taxes only against the trust estate or whether the trustee should be given discretion to pay such taxes against the estate of the settlor also. Disposition of chattels under such a trust agreement is difficult, because such property may not easily be transferred to a trustee during the settlor's lifetime. Banks are usually averse to accepting responsibility for personal property not within their control. If the settlor has an interest in a partnership, he should be advised whether or not it is desirable to authorize the trustee to leave assets in the partnership as a limited partner, at least for a time after the settlor's death. This will depend upon the earning power of the partnership and whether the settlor's interest therein may be readily disposed of. The living trust agreement is sometimes desirable for the transfer of stock in a closely held family corporation in order to prevent dispersal of its stock upon the settlor's death among a number of minor descendants or the spouses of descendants of the settlor.

Some pitfalls exist among the distributive provisions of a living trust agreement and of a testamentary trust. For example, in providing for the surviving spouse, in order to take advantage of the marital deduction, one-half of the adjusted net estate may be left subject to the surviving spouse's distribution by will, but the draftsman should remember that there should be deducted from such one-half interest the value of other property specifically given, or passing under operation of law, such as property held in joint tenancy, life insurance which qualifies, and other assets. This is only of importance, of course, where the surviving spouse already has substantial property subject to death taxes. The fund set up to take advantage of the marital deduction should be set up as a separate fund and all taxes and expenses of the trust paid out of the residue, so as to take full advantage of the marital deduction. The surviving spouse must receive all of the income from the marital deduction fund at least annually and must have the right of distribution at least upon death by will. It is better to make such power one of appointment by will, because then, if the surviving spouse does not exercise the power, the settlor's provisions as to how the property shall be distributed may become effective. Caution should be exercised to make certain that all life insurance policies and annuities which should qualify for the marital deduction and which are under option for the benefit of the surviving spouse also pour into the surviving spouse's estate any unused portions of the insurance funds.

The marital deduction fund will still qualify, even though provision is made for the divesting of the property from the surviving spouse and into the children, in the event that deaths of both spouses occur from a common accident, or the surviving spouse does not survive six months after the settlor's death. The draftsman should be careful however not to qualify that portion of the trust by terminating it upon the spouse's remarriage, or upon any other condition, since there can be no strings upon the surviving spouse's power of disposition by will, if the fund is to qualify for the marital deduction.

The balance of the trust fund may be set up as a separate fund from which the income is payable to the surviving spouse for life without any death tax against the surviving spouse's estate, but if the trustee is to have power to invade the principal of the second fund, this power under the recent federal statute should limit the invasion to a fixed standard of living, or a fixed amount, or to $5000 or five per cent of the value of the principal of the trust fund, whichever is less, within any one year. See Internal Revenue Code, Title 26, Sec. 811, and the 1949 Amendments in the Pocket Supplement. So far as the power of appointment to the surviving spouse is concerned, it may be given also in connection with the second trust fund without an estate tax being imposed, providing it is a special power; that is, exerciseable only as to the descendants or spouses of descendants or in conjunction with a co-donee who has an adverse interest. See the 1949 Amendments to Sec. 811 f. 1, 2, 3 and 4. Special powers are not exempt under Colorado Inheritance Tax Law, Colo. Stat. Ann., chap. 85, sec. 12. But a release of the power may be made without liability for the tax, chap. 128A, secs. 1 to 9.

An advantage of the special power of appointment to the surviving spouse is that it gives the surviving spouse power to distribute at a period much later than the settlor's death in many cases, in accordance with the then needs of the descendants or others. But the same power may be granted to the trustee itself by broad powers of determining the distribution of assets among children. It is not at all necessary that the children should take the funds equally, but the trustee may be empowered, for example, to provide as much money as may be necessary from income or principal for each child until the youngest has attained a certain age or has completed his education, and then the funds may be distributed equally among the children.

Where each spouse has substantial income, it may be well to provide in the trust agreement that the income from the second fund in which the surviving spouse has only a life interest should only be paid to the surviving spouse upon his or her written request, and any income not actually utilized be paid to other beneficiaries, such as the children. This may avoid getting too much income into the hands of the surviving spouse and accomplish an income tax saving. Before the marital deduction is utilized, it is necessary to know what property the surviving spouse is likely to have at death besides that property provided in the trust and to calculate as nearly as possible the estate and inheritance taxes against the surviving spouse's total estate and the possibility of the surviving spouse getting rid of property during his or her lifetime by gifts or expenditures. Sometimes, however, particularly where there are no children, the spouses may not be interested in death tax savings, or the death taxes may be avoided upon the death of the survivor by charitable distributions.

Ordinarily, the American business man seems to have no interest in providing in his will or trust agreement for the spouse of his own child. If that spouse is a woman and mother, the attorney should emphasize to the settlor the lack of wisdom in making provision only for the settlor's grandchildren in the event of the death of the settlor's son, without any provision for the care of the mother of the children.

Where grandchildren become the beneficiaries of the trust, it is perhaps better, unless the trust fund is a very large one, to have the principal distributed to them outright, at least upon attaining majority, because of the expense of trustee's fees in perpetuating a small trust. Here it is all the more important to provide that the trustee may distribute to a parent or one acting in loco parentis to avoid the expense and nuisance of guardianship. Where grandchildren are involved and the trust is to continue, it would seem much better that the trustee be given power to discriminate among the grandchildren according to their educational needs, rather than to disperse the income and principal equally.

One common pitfall in trusts where distribution is to be made to children at different ages (as, for example, half of the principal to a child at age 25 and the remainder at age 30) is the failure to provide for distribution in the event that the child never lives to attain the age of final distribution. The attorney should ask himself at each step in drafting a trust agreement whether he has made provision for every contingency that might occur. The settlor or testator may tell him only that he wants half of his property to go to his present wife, and half to his children by a previous marriage, and that is as far as his mind takes him. The attorney must then drag out of him what provision he wishes made in case his children do not live to receive final distribution, or have no descendants, or any spouse surviving, as well as for the possibility that all of the beneficiaries whom the settlor names may be dead before the trust has terminated.

Practically, it is a good idea often to authorize the trustee to use principal in a certain amount or at the trustee's discretion for children who have passed majority, in order that they may buy a residence or establish themselves in a business, rather than receive all of the principal at fixed ages. The trust may well provide for the payment of the last illness and burial of the surviving spouse and leave to the trustee's discretion whether any of the debts of the surviving spouse may be paid. The spendthrift trust clause should always be inserted in a trust agreement, because it has been approved in Colorado and may save a prodigal beneficiary from disaster. Care should be taken to avoid a violation of the rule against perpetuities, particularly where unborn grandchildren are involved, by making the trust ultimately distributable not later than 21 years after the death of some persons then living.

Specific bequests and devises may be made in a trust agreement, but it is usually better to make such bequests after the death of the surviving spouse rather than before, in case the trust should not be more than enough to support the surviving spouse.

So far as trustees are concerned, it is cheaper to use members of the family or individuals, but in that event there should always be two, and always a provision for a bank to succeed as trustee upon the deaths of the individual trustees. The trust should expressly state that any successor has the same powers and discretion of the original trustees, and the power to appoint another successor. However, the permanent ability of banks to protect investments is usually paramount in a trust of this kind. If an individual and bank are named as co-trustees, the agreement should provide that the bank should have possession of the assets, because this is required under banking laws, but the matter of the expenditure of principal, where there is disagreement among the co-trustees, may be left to the individual trustee rather than to the bank, because it is probable his knowledge of the family needs is greater. The trust agreement should always provide that the trustee shall have power to sell real estate or personal property without order of court, where real estate is, or may become, a part of the assets.

Where distribution is to be made to children or grandchildren at certain ages, it is well to have their birth dates set forth in the trust agreement and made conclusive upon the trustee, in order to save the trustee the trouble of obtaining evidence of birth dates. If there is any possibility of the settlor having unborn children, provision should be made for their sharing in the trust also. The usual clauses governing the powers of the trustee may be obtained from any of the trust departments of the banks. The clause giving the trustee power to determine how disbursements shall be credited between income and principal is an important one, because there is more likely to be a contest between beneficiaries over this subject than perhaps any other in the trust agreement. The trustee may be given the right, in the event of dispute, to determine allocations and apportionments as between income and principal according to the Restatement of the Law of Trusts, which is pretty detailed in this connection, in order to avoid the expense of a court contest.

A settlor may wish during his lifetime to control the trustee in the sale or purchase of investments, or have his wife or someone else do so after his lifetime, and such a provision may, of course, be inserted. If the trust is to be subject to revocation there should be a clause expressly so providing, because without it the instrument is presumed to be an irrevocable trust. The provision should be for the right of revocation or amendment from time to time. The trustee should be required to report to the adult beneficiaries concerning assets and disbursements and there should be a reasonably definite clause concerning the trustee's fees.

Settlors at times desire to leave from the residue of the estate certain definite amounts to certain persons or institutions. This should be discouraged and the distribution should be made in percentages or shares because of the fluctuation in the value of the assets from time to time.

TESTAMENTARY TRUSTS

Most of the comments above are applicable to testamentary as well as living trusts, and no additional comments seem to be called for under this heading, except to stress the fact that, if the testator is dead, there can be no revocation or amendment, and therefore farsightedness and accuracy are of the greatest importance.

Some mention, perhaps, should be made of foreign real estate in connection with the selection of a trustee and with charitable devises or bequests.

Where real or personal property is owned by the testator in a foreign state, ancillary administration is usually necessary and the will should provide for an ancillary, as well as domiciliary, executor. Whether an ancillary trustee should also be selected will depend upon the laws of the foreign state. Some states, as California and Kansas, do not permit foreign banks to qualify as trustee, or hold title to real estate. Some do not even permit a non-resident individual to qualify as executor. Furthermore, there are laws in some states limiting the amount of the estate or trust estate which may be left to charity. Where only personal property is situated in the foreign state, the problem is not so great, as in the case of real estate. Before the will is drawn these laws should be carefully examined. In some instances it may be better for the testator to dispose of his foreign holdings during his lifetime, or it may be possible to have the proceeds of foreign land, intended for charity, distributable to an individual, who in turn by separate trust agreement, agrees to distribute the proceeds upon receipt to the charity involved.

Canadian stocks and bonds are a nuisance because of the necessity in an estate of returning succession duty returns both to the province of incorporation and to Canada, and paying a tax.

It is the author's hope that some of these suggestions may be helpful to those lawyers who have not had much experience in the drafting of trusts. They are not intended, of course, to cover all of the problems which may arise.

SUPPORT AMENDMENT NO. 1

Constitutional Amendment No. 1 will be on the ballot in the November general election. The provisions of this amendment are non-controversial and its passage will cure three ills now afflicting our judicial department. The measure has the support of both political parties, is endorsed by the District Judges Association and County Judges Association and is a small but vitally important part of the judicial reform program of the Colorado Bar Association. We know of no opposition to this measure but energetic support must be given by every lawyer and lover of good government to secure an affirmative vote on the amendment and to overcome the strong tendency of electors to vote against all constituional changes. Take time to explain the purposes of this amendment to every voter whenever and wherever an opportunity presents itself. The text of Constitutional Amendment No. 1 and an explanation of its provisions may be found at page 338 of the September, 1952, issue of *Dicta*.

THE ROLE OF THE LIFE UNDERWRITER IN ESTATE PLANNING

LOUIS C. HALLEY
Educational Director, Colorado Life Underwriters

The life insurance industry and the method of marketing life insurance have, in the last century, traveled a long road—a road which has been filled with changes. We underwriters today have the benefit of these changes—all of them for the betterment of the business—until today the educational process of a life insurance man lasts from the day he enters the business to the day he dies. There have even been set up training standards which lead to the attainment of a recognized professional degree. It is interesting to note that, in securing that degree, the recipient agrees to follow the principles which are laid down by the Golden Rule.

Perhaps the most widely recognized estate planner living in America is Mayo Shattock. Mr. Shattock has written several textbooks on estate planning. He likes to think of a man's estate being arranged by a four man team consisting of an attorney, a trust officer, a certified public accountant and a life underwriter. Naturally the captain of that team would be the attorney.

In my preparation for this article a lot of research has been done, and one fact stands out above all others—the need for cooperation between attorneys and life underwriters. I realize that the comparison which I make is very unfair, since an attorney cannot go out and aggressively sell his business of practicing law and making wills with the same determination and persistency we use in selling life insurance. I was astounded to learn that there were some 2,000 attorneys in the State of Colorado. On the other hand I understand there are some 600 full time life insurance men (excluding part time agents). Again delving further into the results attained by these two groups of people, I found that about 50 per cent of the people who die in Colorado die intestate, whereas only five per cent of the people who die in Colorado die without life insurance. As stated above, I realize that this is an unfair comparison, however, I cannot help but point it out because the two groups working together can eliminate this condition.

The day is past (or at least certainly should be) when a client will walk into an attorney's office and say, "I want to draw a will" to which the attorney replies, "Fine what do you want in your will?" In an article appearing in the American Bar Association Journal for December, 1950, it is pointed out that if the client had known what he wanted in his will, he would not have had to come to an attorney in the first place.

To integrate life insurance into estate tax planning requires a good deal of acquaintance with the intricacies of the life insurance contract itself. For our purposes, particular emphasis should be placed upon the various income settlement options selected by the insured for a beneficiary where the proceeds are held on deposit with the insurance company, and will also involve questions pertaining to the ownership of various types of contracts. The latter may arise where there has been an irrevocable designation of beneficiary or absolute assignment of the policies. Then, too, special rules applicable to life insurance, endowment, and annuity contracts are provided under specific sections of the Internal Revenue Code for ascertaining the federal estate tax liability of policies which the insured does not own, although includable in his gross estate at death, if the Internal Revenue Bureau can sustain a contention that the insured paid the premiums even indirectly. Your qualified life underwriter is familiar with all of these items and can furnish the answers to the questions of the attorney quickly.

I was very impressed by all of the speakers on your recent institute program in their talks when they settle mythical estates of $200,000, $300,000, $500,000 and even $1,000,000. I cannot help but believe that the little man, the man who dies leaving an estate of $10,000 or $15,000 is more in need of the joint services of the life underwriter and the attorney. These smaller estates which have been built up perhaps at even a greater cost in time and effort than your huge estates, show the necessity of estate conservation even more than does the larger estate. I cannot help but feel that $500 shrinkage to the family of a decedent who died leaving an estate of $10,000 means more to that family than $100,000 does to the estate of a man who left $1,000,000.

COOPERATION NEEDED

I appeal to the entire membership of the Bar Association for more cooperation between attorneys and life underwriters. It can and must be accomplished. If we, in the life insurance business, knew that by going to an attorney, our interests would be as much protected, as one attorney going to another attorney, these little men would be crowding attorneys' offices to get their affairs in shape. You see, we are all working toward the same end, although we start out with entirely different objectives. In order for you to settle a man's estate, he must first of all have an estate. We, on the other hand, go out and by the single stroke of a pen, create estates where none had existed before.

Some eight or nine years ago I had an experience about which I would like to tell you. It involved an attorney and myself and was just one of those things that should never have happened. I was an agent in St. Louis, Missouri, and I prepared the death claim papers on a life insurance policy involving payment of $75,000. This was not this man's entire estate, nor was it all of the life insurance that he had. After I had the undertaker's (they call them morticians now) paper completed, the doctor's paper, and the claimant's statement filled out, I talked to the widow about her future plans for this money. She then told me that her husband had always singled out this $75,000 policy to be divided equally between their three minor children. She also told me that she was going to withdraw this $75,000 from the life insurance company as she thought the 3½ per cent interest guarantee was inadequate. I came back with the idea that if she were to invest $38,000 of this money in a single premium life policy, we would insure her life for $75,000, and she could name the three children as joint beneficiaries. This would leave her $37,000 which she could even lose and she would still have carried out her husband's wishes. She agreed to this proposition, so I took her application, and she promised to be examined the next day. The next afternoon, she called and told me she was not going to buy the insurance. She had been to see her attorney, and he told her the company I represented was no good. I told her I would be happy to place the insurance with any company her lawyer recommended. She then told me her lawyer had already sent out an agent of another company. He had taken her application and was waiting for her at that time to take her to the doctor to be examined.

If we, the life underwriters, and you, the attorneys, were to share in the type of cooperation which I am appealing for, who would benefit more? The attorney? The life underwriter? I don't believe so. I think it would be our clients.

I would now like to ask you to permit your imagination to go with me to a wedding. Someone once asked for a very simple explanation, in one sentence, of just what estate planners do. Here is a good definition: "Estate planners are individuals who wed a collection of assets with a collection of objectives and do everything possible to make the marriage a happy and fruitful one."

Objectives of Estate Planning

In the course of this duty, estate planners perform some rather unusual services. They must first hunt for the objectives. These can be very elusive. Sometimes it's necessary to leap in the air to bring them down to earth, other times they are found almost suffocated beneath a mass of everyday routine activities. But when they are finally found and harnessed, they generally involve solution of the following problems for the client:

1. When and how I plan to retire and how much I will need at that time.
2. What I would like my children to have for educational, dowry or business purposes. Special bequests for others.
3. What I would like to have on hand as a fund for emergencies or special opportunities.
4. What I want to do about my business interest to safeguard my family and my faithful employees.
5. What I want my family to have when I die.

Now that we have formulated the objectives (brides), the estate planner is faced with the much more difficult task of finding, rehabilitating and introducing the assets (grooms) to the objectives. Then we bring the preacher (attorney) into the picture. Perhaps the best man (the life underwriter) was the first to call on the minister to make him aware of the budding romance. The minister then becomes the master of ceremonies, and he interviews the parent, otherwise known as the client, about the honorable intentions of the bride and groom. Assets will take almost any possible shape and are not always recognized as such by their owners. This is the preacher's job. What form might they take? Well, they might be bonds, stamp collections, or life insurance policies. Perhaps the beneficiaries named in the life insurance policies are already dead. Perhaps the settlement option which has been selected is no longer appropriate, and perhaps a change of plan might be necessary, or it's entirely possible and probable that there is not enough of this one particular asset which provides the ultimate in liquidity, and the life underwriter (best man) must be consulted. Sometimes the assets even take intangible forms, such as good will or some highly specialized talent. A surgeon's hands are only assets so long as he is able to use them. Other assets, for instance, life insurance, again come into being or increase in value when death of the owner occurs.

After locating these assets, the attorney must make certain that they are in sufficient quantity and in proper condition for the prospective brides. He might look at the government bonds, real estate, and business interests; one by one they must be thoroughly dusted off, X-rayed, and treated until they are in good physical shape. Sometimes it is wise to acquire more of one particular asset with qualities that the others do not possess. Again, sometimes assets such as business interests are discovered to be secretly plotting to stray from home the moment the parent dies. These plots must be frustrated forever.

The minister, after interviewing the prospective bride and groom, unites them in holy matrimony, but this job does not end there. Frequent visits are necessary to keep the married couple happy because now a collection of assets and a collection of objectives that might never have met are united. The best man also pays frequent visits because births, deaths, changing conditions, or a change of business interests might require his further services.

The foregoing illustration is for the little man with a $10,000 or $15,000 estate. If the parent is a wealthy person, additional consultation is needed—perhaps groomsmen will be added to the ceremony in the form of accountants and trust officers. This team must realize that team work is essential for a happy marriage and should lend every cooperation with each other to assure a long, happy married life.

In closing I would like to repeat—estate planning consists of team work. It consists of the whole team fighting to benefit the client. With cooperation between the attorney and the life underwriter, the client cannot help but have the advantage of their combined knowledge.

THE WILL IN ESTATE PLANNING

CHARLES E. WORKS
Professor, University of Denver College of Law

Since other papers published in this series deal with the important and complicated problems of tax minimization and the creation of trusts (including testamentary trusts), we shall confine this paper to the comparatively simple problems of will-drafting in general. Even though the matters discussed will probably be familiar to all attorneys, a summary of common pitfalls with some reference to Colorado law should be of value. Mistakes in the preparation of wills are more apt to be due to oversight than to a lack of knowledge of the law. Every attorney should build up a check list of points to be considered in drafting wills and should from time to time refresh his memory by reading or rereading a good book on estate planning.[1]

NECESSITY FOR A WILL

A will is usually desirable. In many cases it is important for a man to disinherit children and leave all his property to his widow. Even if a client desires his property to go to his heirs at law, a will is usually desirable. Where minors are involved, a will can obviate the expense of a guardianship by the creation of a simple trust to handle the minors' property until the age of 21 years. Even if there is no possibility of minor heirs, a will usually produces a better, cheaper result than an intestate administration. The will can assure a qualified executor, the elimination of the expense of a bond, savings by distribution in kind, and a more expeditious and efficient disposition of assets through sales without court order.

Of course all administration and administration expense may be avoided if a man arranges his affairs so that he dies with no property worth over $500, except insurance policies payable to named beneficiaries, property owned in joint tenancy, a joint bank account, U.S. bonds issued in two names and property held in an intervivos trust.[2] Under some circumstances this plan will be preferable to a will, but it has its dangers. It precludes the flexibility usually desirable in an estate of substantial size. Even in a small estate it frequently is unsuccessful because some asset requiring administration has been overlooked.

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[1] See check list of Hubert D. Henry, 27 DICTA 273 (1950).
The following books are very helpful:
Harold Schwarzberg and Jules E. Stocker, *Drawing Wills.* (Practising Law Institute, 1946.)
Harrison Tweed and William Parsons, *Lifetime and Testamentary Estate Planning.* (American Law Institute, 1951.)
Joseph Trachtman, *Estate Planning.* (Practising Law Institute, 1949.)
Mayo Adams Shattuck, *An Estate Planner's Handbook.* (Little, Brown & Co., 1948.)

[2] See, Merrill A. Knight, *Simple Devices for the Transfer of Assets Without Administration,* 27 DICTA 277 (1950).

In many situations a joint tenancy is undesirable because the parties may have friction or a divorce, the financial or personal factors may change, and if the property increases in value, the survivor will have a greater capital gains tax on the sale of the property than if it were received by inheritance or by will.

There is some danger in a joint bank account. In a recent Colorado case,[3] the decedent had put money in a joint bank account in the names of the decedent and friend A, with an agreement that A was to withdraw the money only after decedent's death and then was to distribute it to certain of decedent's relatives. The court held that the device was a testamentary plan and invalid and that the bank account passed as intestate property. Apparently, a joint bank account will pass the property to the survivor in the ordinary situation where both parties draw on the account and the survivor is under no obligation to dispose of the proceeds to other persons. This case at least casts doubt on the effectiveness in Colorado of the so-called "Totten trusts," e.g., where decedent deposits money in a savings bank "in trust for" some other person.

Will or no will, some money in a joint account or some insurance proceeds may be desirable to provide ready cash for living expenses during the period of administration.

General Problems of Will-Drafting

A testator often thinks he knows just how he wants his will drawn, but more often than not his preconceived ideas will not carry out his real desires and purposes. The attorney's function is not to tell the client what to do with his money, but to advise the client how to do what the client wants to do with it. To do this the attorney must know all the facts—facts regarding the client's family, the amount and nature of all the client's assets, in whose name or names title is held, the client's probable debts, the financial situation of intended beneficiaries, and what property is to be received by beneficiaries outside of the provisions of the will (such as joint-tenancy property, life insurance proceeds, U.S. bonds in two names and trust funds). The attorney must also be informed of any substantial gifts made or trusts created by the client which might be subject to estate or inheritance or gift taxes. The client should be advised as to the probable shrinkage in his estate due to taxes and administration expenses, and should be informed of the advisability of having sufficient life insurance proceeds or other liquid assets available to the executor to pay all taxes, expenses and debts, and of having ready cash available to the family for living expenses.

If the attorney knows all the facts, it is comparatively simple to draw a will which will carry out the testator's desires if the testator dies immediately. But the testator may not die for many years, during which time his financial and family situation may

[3] Urbancich v. Jersin, 123 Colo. 88, 226 P. 2d 316 (1950); noted in 23 Rocky Mt. L. Rev. 349 (1951).

change very materially. Most testators fail to appreciate all of the contingencies which may arise before death or during the period of administration. Many testators are unconcerned by the problem of changed circumstances, because they are sure that they will make new wills whenever necessary. Experience shows that all too frequently a testator neglects to make a new will even when it is essential. It is possible that the testator may be prevented from making a new will by mental incapacity. For these reasons the attorney should consider all likely contingencies (such as the testator's divorce, an increase or decrease in assets or debts, a change of the form of assets owned, a change in the purchasing power of money, a change in the family situation, the birth or adoption of children, the possible marriage or divorce or death of a beneficiary), and should draw a will which will probably carry out the desires of the testator under whatever circumstances may exist at the date of death. This is a difficult task; of course it is impossible to draw a will which will be the most desirable will under every conceivable set of circumstances which may arise. Flexibility to meet changed conditions can best be obtained by a testamentary trust with broad discretionary powers in the trustee, but even when a trust is not desired, the problem must be tackled. Probably most testators would be surprised to learn that a divorce does not revoke a will and that a will leaving "all my property to my wife Helen" would be effective even if Helen were divorced from the testator at the time of his death,[4] but that if they had been divorced and were remarried at the time of his death, the will would be invalid.[5]

If the testator makes a will in Colorado and dies domiciled in another state, the law of that state will probably apply as to the validity and construction of the will and the administration of the estate as to personal property wherever located; as to real property the law of the state where the property is situated will apply. A will can and should be drawn so that it will probably be effective under the law of any state. As to execution, a will executed according to Colorado law with the usual attestation clause if witnessed by *three* witnesses should be valid in any state and in most foreign countries.

It is important to provide for flexibility in the administration of the estate. In most cases it is advisable to give the executor power to sell real or personal property without order of court, power to retain an asset of the estate even if retention will result in lack of adequate diversification, and power to distribute in kind. If there is a likelihood of the testator's owning a business at his death, the will should provide under what circumstances and for how long the executor may continue the business and what funds may be used for this purpose. Our present Colorado law gives broad investment powers, but if the law of some other state may apply, investment powers should be set out in the will.

[4] *Semble*, Moore v. Handley, 97 Colo. 258, 48 P. 2d 808 (1935).
[5] In Re Estate of Matteote, 59 Colo. 566, 151 P. 448 (1915).

Under a given set of circumstances probably no two attorneys would give identical advice, and probably no two testators would want exactly the same will. The will must be "tailor-made" to fit the circumstances and desires of the particular testator. A very short, simple will may be the solution, but the result should be reached only after consideration by the testator and the attorney of all the factors involved. The promiscuous use of stock forms should always be avoided. In advising a client as to a will, the attorney is not merely solving legal problems, but is helping the client solve problems regarding the care and welfare of human beings and should never overlook the personal factors involved.

GENERAL LEGACIES

Unless the testator is sure that he will die very shortly, it is dangerous to leave general legacies of substantial sums of money. For example, a testator with $1,000,000 makes a will leaving $100,000 to X University and the residue of his estate to his family. If he meets financial reverses and dies with only $100,000, his family will receive nothing. A safeguard against such a contingency is to leave $100,000 to X University, provided that if this sum exceeds 10% of the net estate, the gift is to be cut down to 10% of the net estate. On the other hand the testator may wish X University to receive more than $100,000 if his estate is larger than $1,000,000. In that event he can leave 10% of his net estate to X University.

Here lurks a great danger. Assume that a testator wishes to treat his two sons equally and leaves Blackacre to his farm-minded son A and an equal value of specific corporate stock to son B. If oil is struck on Blackacre and the stock depreciates in value, the testator's main object is defeated. Furthermore there is the danger of ademption; if the testator sells Blackacre or trades it for Whiteacre or if it is taken on condemnation proceedings, A gets nothing. Similarly B's gift may be defeated if the testator sells the stock or if it is exchanged in a reorganization or merger for new stock which the court feels is a change in substance rather than in mere form. Even a stock dividend may cut down the value of B's gift. A gift of "10 shares of X stock" will be treated as general and not subject to ademption, whereas a gift of "*my* 10 shares of X stock" is a specific gift subject to ademption.[6] It is much safer to give the principal beneficiaries fractional shares of the estate or of the residue than to leave them specific gifts of the major assets.

While specific gifts of major assets are to be avoided, property having primarily a sentimental rather than monetary value (such as heirlooms, furniture, jewelry and personal effects) is usually specifically bequeathed. Such property should not be allowed to pass into a trust fund, nor should it go into the residue as it may then have to be sold. If such property is given to several persons in equal shares, family squabbles may be avoided by giving the executor broad authority as to the method of division. Frequently

[6] Bond v. Evans, 92 Colo. 1, 17 P. 2d 311 (1932).

a testator wishes to have his effects divided among friends or relatives in accordance with directions which the testator will give after the will is executed and which may be changed from time to time. This is clearly illegal, and there is no safe way to accomplish this result unless the testator is willing to leave the property outright (with no strings attached and no desires or wishes expressed) to some person who the testator trusts will carry out the moral obligation. Such person might be legally bound as a constructive trustee, but this involves uncertainty as to proof. Such a device should not be used if the property is of sufficient value to be subject to gift taxes.

Frequently the testator will wish to make a specific gift of the family residence rather than have it pass into the residue. If he leaves "my residence at No. 100 Main St." and later sells it and purchases another residence, nothing will pass. The will should clearly state that any residence owned at the time of death is to pass; but in wording the will, consideration should be given to the possibility of the testator having more than one residence, such as a winter home and a summer home. If a residence or any other property is given specifically and there is the possibility that it will be encumbered, it should be stated whether it is to pass subject to the lien or whether the executor is to pay off the lien from other assets of the estate.

Priority of Legacies

If there are insufficient assets to pay all of the legacies, some will be abated. The testator can provide the order of abatement. For example, if the will leaves an automobile to A, $10,000 to B and $10,000 to C, it may also provide that if the assets are insufficient to satisfy all three gifts, the gift to A shall abate first, then the gift to B. This will give C the first preference and will generally be much more satisfactory than an attempt to prefer C by the clumsy and uncertain device of a demonstrative legacy, e.g., "$10,000 to C, payable out of my savings bank account."

The law is not entirely clear as to how gifts will be abated if the surviving spouse elects to take the statutory share instead of taking under the will. The will should make it clear how the balance of the estate is to be disposed of in this event.

Life Estates and Remainders

Where property is not to be given outright, a trust is usually advisable. If a legal life estate and a legal remainder are created, the will should state whether or not the life tenant is to post a bond and is to be liable for repairs and waste. The will should also state who is to take in the event the remaindermen all die before the life tenant. If a remainder (either legal or equitable) is created for a class, extreme care should be exercised in defining the class and the time at which the class is to be determined. For example, a gift "to A for life and then to A's children" is ambiguous. Are children born to A after the testator's death to take?

Do the children take a vested remainder, or is their interest contingent on surviving A? What happens if A has a child who dies before A, leaving issue who survive A?

CHILDREN, AFTER-BORN CHILDREN AND ADOPTED CHILDREN

Does a gift to "children" or "issue" or "descendants" include adopted children? The Colorado Supreme Court has held that a gift to the testator's children includes adopted children, but a gift to the children of any other person does not include adopted children.[7] The will should clearly specify whether or not adopted children are to be included. Certainly most testators intend to include their own adopted children. Suppose a testator leaves property in trust for his child A for life with a remainder to A's children. Probably most testators would wish children adopted by A *bona fide* to take whether adopted before or after the date of the will or the date of death. But the fact that an adult may be adopted, would put A in the position of being able to make an advantageous deal to adopt a friend and thus defeat a gift over to other relatives of the testator.

Frequently a testator wishes his widow to take all of his property to the exclusion of any children. In most states (including Colorado), children born after the will is executed will take their intestate share unless expressly disinherited, and in many states (not including Colorado), children alive when the will is made will take unless expressly excluded. Every will should name all existing children (natural or adopted) and should state whether these children and any children born to, or adopted by, the testator after the will is made are to take or are to be disinherited. A Colorado case[8] dramatically illustrates the necessity for such a provision. The testator, who had a child A, made a will leaving all his property to his wife with no mention of children. Child B was later born to the testator who later died, survived by A, B and his widow. The court held that A was disinherited and took nothing, B took his intestate share of one-quarter and the widow took three-quarters of the estate.

Whenever any person or persons under 21 years of age may be entitled to property under a will, it is important to consider the advisability of avoiding the expense and red-tape of a guardianship of the property. This can be accomplished by a trust, or, in the case of tangible property of no investment value, by directing the delivery of the property to the person having custody of the minor. If a minor is given an interest in a trust fund, the trustee can be authorized to expend the money for the minor without a guardian being appointed.

Ordinarily a gift to children will not include illegitimate children. In this day of Mexican and Reno divorces of doubtful validity, the legitimacy of children born of a subsequent marriage

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[7] Brunton v. International Trust Co., 114 Colo. 298, 164 P. 2d 472 (1945).

[8] Lowery v. Harlow, 22 Colo. App. 73, 123 P. 143 (1912).

may be questionable. In rare cases it may be advisable to insert a provision to insure that such children will take regardless of the jurisdictional infirmity of the prior divorce.[9]

LAPSE

Since the anti-lapse statutes vary from state to state, it is a wise precaution to insert the condition "if he survives me" in connection with each gift. If the lapsed legacy is not to pass into the residue, the will should provide specifically who is to take in case the legatee predeceases the testator.

RESIDUARY CLAUSE

Unless the will expressly applies to all of the testator's property, there should be a residuary clause so as to make sure that there will be no intestate property. Powers of appointment are more commonly used since the Revenue Act of 1948, so it is now always advisable to determine whether the testator is the donee of a power or is likely to become the donee of a power. The will should expressly state whether it is, or is not, to operate as an exercise of the power. A general residuary clause may be construed as the exercise of a power. This may have unexpected tax consequences. Also if the will creates trusts, they may violate the Rule Against Perpetuities as to the appointed property, since the period starts to run from the date of creation of the power rather than from the date of the death of the donee of the power.

It is important to make sure that there will be no failure of legatees under any contingency. If the will leaves the residue "to A, B and C in equal shares" and A dies before the testator, B and C will take only two-thirds of the residue and one-third will be intestate property.[10] Even if the will provided that A, B and C or such of them as survived the testator should take the whole residue, there would be no disposition of the property if all three of them predeceased the testator. There should be a catch-all provision stating who is to take in the event all legatees or contingent legatees predecease the testator or all remaindermen predecease a life tenant. The property may be left to a charity sure to be in existence, or to the persons who would be the testator's heirs if the testator had died at the time of the failure of the gift.

PAYMENT OF TAXES

Regardless of all questions of tax minimization, every will should specify how the burden of the federal estate tax and state inheritance taxes is to be borne by the different legatees. If a testator leaves $1,000 to A and a diamond necklace to B, he will usually want the taxes paid out of the residue so that A and B will receive their gifts tax-free. Consideration must be given to the taxes on property which does not pass under the will, such as life insurance, joint-tenancy property and inter-vivos gifts taxed

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[9] Shattuck, *op. cit.* note 1 at pp. 364, 365.

[10] Feeney v. Mahoney, 121 Colo. 599, 221 P. 2d 357 (1950).
Feeney v. Mahoney, 123 Colo. 448, 231 P. 2d 465 (1951).

as in contemplation of death. No general rule can be laid down as to the best tax apportionment provision for all situations.[11]

ADVANCEMENTS

Advancements made prior to the execution of a will are not taken into account unless the will so provides. Payments made to a legatee after the making of a will may or may not be considered as made in satisfaction or partial satisfaction of the legacy, depending on the circumstances. In some cases where property is left to children in equal shares, the testator may want a provision that any sum paid to any child is to be taken into account by way of hotchpot.

INCORPORATION BY REFERENCE

If possible, an attorney should avoid uncertainty by putting all provisions in the will itself. Often a testator wishes to have part of his estate added to an existing intervivos trust, and incorporates the terms of the trust by reference. If the trust is revocable or amendable, the gift will probably be invalid unless the will makes it clear that the property is to be held according to the terms of the trust as it existed at the date of execution of the will regardless of future amendments. Gifts to charitable trusts whose papers are filed with the Secretary of State may be made by reference even if the trust is amendable and is amended after the will is made.[12]

COMMON DISASTER CLAUSES

The Colorado Simultaenous Death Act does not apply to a situation where there is any substantial evidence that one of the parties survived the other by even a few seconds.[13] To meet this situation, some attorneys insert a provision in the will that the legatee shall not take if he dies as the result of a common disaster with the testator. This provision is subject to the objections that the cause of death is sometimes uncertain and that the survivor may linger for an indefinite period. A provision that the legatee shall take only if living thirty days (or any other period not exceeding six months) after the date of death of the testator would appear to be more certain and effective. Such a clause should not be used regarding a spouse if it is more important to get the benefit of the marital deduction for estate tax purposes than to prevent the property passing to the spouse's estate. It is probably wiser to omit any provision on the subject, except in cases where the spouses have no children and survivorship will determine whether the property goes to the husband's relatives or the wife's relatives.[14]

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[11] Trachtman, *op. cit.* note 1 at pp. 48-55; Tweed and Parsons, *op. cit.* note 1 at p. 68.

[12] COLO. STAT. ANN., C. 4, §§184-186 (1935).

[13] Sauers v. Stolz, 121 Colo. 456, 218 P. 2d 741 (1950).

[14] Trachtman, *op. cit.* note 1 at pp. 56-63.

MUTUAL WILLS

If two persons contract orally or in writing to make wills in which each leaves all of his property to the other, or in which each leaves a life estate to the other with the remainder to a specified person, the wills are irrevocable and the contracts are enforceable in equity. It has been held in Colorado that the simultaneous execution of mutual wills creates a presumption of such a contract.[15] Obviously such contracts should not be entered into in most instances. Many husbands and wives simultaneously make mutual wills with no intent that either party shall be under obligation not to change his will. In such case it is essential to have some evidence that there was no contract between the parties. A statement to this effect in each of the wills should be sufficient, if the wills are executed in duplicate and an executed copy of each will is retained by the attorney. This will not be satisfactory to those attorneys who object to the execution of wills in duplicate. If the wills are not to be executed in duplicate, or if it seems inadvisable to put such a provision in the wills, it is a simple matter to have a statement of the facts signed by both parties and witnessed by the attesting witnesses to the wills. If such statement is executed in triplicate and one copy kept by each party and one copy kept by the attorney, there should be no difficulty in rebutting this rather artificial presumption.

PAYMENT OF DEBTS

It would seem to be immaterial whether a will is silent as to payments of debts, or directs the executor *not* to pay any debts, or directs that all just debts be paid. In any event the statutes provide for the payment of debts. A direction to pay debts should not protect an executor who pays an invalid claim or pays a debt barred by a Statute of Limitations or non-claim.[16] The insertion of such a clause might open the door for the argument that the testator intended to make the executor a trustee to pay all creditors whether their claims were barred or not and whether filed or not. If the testator wishes specific barred claims or unfiled claims paid, he can specifically give the creditor a right as a legatee but not as a creditor. A general direction to pay debts appears to be futile at best and might create an uncertainty.

CONCLUSION

This paper has pointed out a few important problems which might be overlooked, with no attempt at complete coverage or complete discussion. I hope that the discussion has been sufficient to illustrate the necessity for an estate plan in every case and for the careful search for unexpected contingencies which may arise. The exact wording of a will is also a matter requiring great care.

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[15] Trindle v. Zimmerman, 115 Colo. 323, 172 P. 2d 676 (1946).
Hoff v. Armbruster, ... Colo. ......, 242 P. 2d 604 (1952).

[16] Crowley v. Farmers Bank, 109 Colo. 146, 123 P. 2d 407 (1942).

Former Judge Kettering of the Denver County Court once remarked that the most common weakness in will-drafting was the inability of the will draftsman to use the English language clearly and precisely. No will of any complexity should be signed until at least two attorneys have checked it—every one of us occasionally has an intellectual or linguistic blind spot. Finally, the attorney's job is not complete unless he periodically checks the wills he has drawn in the light of any changed conditions and reviews the situation with his client whenever a new will may be advisable.

TRANSFERS TAKING EFFECT AT OR UPON DEATH

T. RABER TAYLOR
of the Denver Bar

When we talk about transfers taking effect at or upon death we are generally talking about rich man's law. Generally we are talking about the Law of Trusts and the Law of Future Interests and their impeding effect on the imposition of death taxes and income taxes. A short translation of the terms "transfers taking effect at or upon death" is a *string* between the donor and the donee. Unfortunately, it is this string upon which has been played the sad note of tax victories for the Government.

Any study of transfers taking effect at or upon death is also a study of the law of the Philadelphia property lawyer. The first inheritance tax law in the United States was passed in Pennsylvania in 1862. This law anticipated the desire of Philadelphia property lawyers to avoid the imposition of the inheritance tax which applied to property passing at death. Accordingly, the law imposes the inheritance tax on transfers intended to take effect in possession or enjoyment at or upon death. The techniques developed by the Philadelphia property lawyers were brought into the Federal tax area with the passage of the Federal Estate Tax Law in 1916. From the passage of the federal law on September 8, 1916 and down to 1935, well drafted property law trusts involving future interests, were successful in insulating large estates from the federal estate tax. Some of the celebrated taxpayer victories well known to us are: *Shukert v. Allen,*[1] *Reinecke v. Northern Trust Company,*[2] *May v. Heiner,*[3] and *Helvering v. St. Louis Union Trust Company.*[4] Each of these decisions, with the exception possibly of *Shukert v. Allen,* has been expressly overruled either by the United States Supreme Court or by Congress. The tide began to run against the taxpayers in 1940. You all recall the celebrated case of *Helvering v. Hallock* [5] which reversed *Helvering v. St. Louis Union Trust Company* and held that whenever

[1] 273 U. S. 545 (1927).
[2] 278 U. S. 339 (1929).
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[5] 309 U. S. 106 (1940).

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there was in the decedent a possibility of reverter that the entire estate should be subject to federal estate tax. You also recall *Commissioner v. Church's Estate* [6] in 1949 which expressly overruled *May v. Heiner*. The Technical Changes Act of October 7, 1949 has repudiated *Reinecke v. Northern Trust Company*.

Not only clients, but also lawyers, tend to believe that property transferred in trust with just a little string attached should do no harm. Small lines have destroyed great ships and sent them onto the rocks and shoals. Let us hope that none of the instruments with which you and I are identified will ever put our client's "treasure trove" into the sovereign's treasury.

To you it is obvious that "transfers intended" are found most frequently in the pattern where the husband-father-grantor has created trusts or made other transfers for the present or future benefit of his wife and children. In most of the cases, the trusts have been irrevocable trusts. However, life insurance and annuity contracts have also run afoul of the taxing words.

Transfers intended to take effect in possession will cause heavy imposition of death taxes because recently many advisers, lawyers as well as life underwriters, have been near-sighted. They focused attention on the Federal Income Tax Law. You all recall that in 1943 the Federal Income Tax Law amended Section 167 (c) for two purposes: (1) to counteract *Helvering v. Stewart;*[7] and (2) in order to give income tax relief to some parent-grantors who had created irrevocable intervivos trusts for minor dependents.

Some advisers and some lay men have been by this federal income tax section lulled into a false sense of security. Under this section, the federal income tax consequences are fairly clear as it applies to one widely used type of trust clause. The section contains provisions for accumulation of income during the minority of the beneficiary with a further provision that the trustee may apply to the use of the child so much of the income as the trustee considers proper for education, maintenance or support. In fact, the Federal Income Tax Regulations (Reg. 111, Section 29.167-2), and those under the *Clifford Doctrine*, expressly except from their broad scope any contention for income taxation of the grantor, contrary to Section 167 (c), Reg. 111, Sec. 29.22 (a)—21 (d).

In passing, let us point out that the Colorado Income Tax Law [8] has not been amended to parallel Sec. 167 (c) of the federal law.

Our focus of attention is on estate taxes. Unfortunately, we find no counterpart of Code Section 167 (c) in the estate tax chapter of the code. On the contrary, we find the dragnet trap amendment of the Technical Changes Act of 1949 taxing practically all transfers intended to take effect in possession or enjoyment at or after death.

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[6] 335 U. S. 632 (1949).
[7] 317 U. S. 154 (1946).
[8] Colo. Sec. 13(c), Reg. p. 151, Art. 13 (c).

Every trap is designed to catch certain victims. Let us block out the arrangements that will be trapped:

(1) The decedent transferred property in trust, to pay the income to his wife during her life, and at her death to pay the corpus to the decedent if living, and if not, to his children. The decedent was survived by his wife. The value of the transferred property, less the outstanding life estate in the wife, is includible in the decedent's gross estate since the children cannot obtain possession or enjoyment of the property, through ownership of their interest, except by surviving the decedent.

(2) The decedent transferred property in trust to accumulate the income during his life and at his death to distribute the principal and accumulated income to his son or the son's estate. While the decedent retained no right or interest in the property, the transfer is taxable since possession or enjoyment of the property cannot be obtained except by surviving the decedent.

(3) The decedent transferred property in trust, to accumulate the income until his son reached the age of 30, or until the decedent's prior death. Upon the first to occur of these events the son was to receive the corpus. The decedent's death in fact occurred before his son attained the age of 30. The transfer is taxable under Section 811 (c) (3) (B) since the son could obtain possession or enjoyment only by surviving the earlier to occur of the decedent's death or the son's attaining age 30, and since the decedent's death in fact occurred first.

Now for two arrangements that are not supposed to be trapped:

(1) The decedent transferred property in trust, providing for an estate for life in his daughter, and a remainder to the children of the daughter. No part of the property is includible under this section. The daughter can possess and enjoy the property through ownership of the life estate without surviving the decedent. The same is true of the daughter's children with respect to their remainder interest.

(2) The decedent transferred property in trust providing for accumulation of the income during his life, and at his death to pay the entire fund to his children or their issue. His wife was given the unrestricted power to alter, amend, or revoke the trust. The wife survived the decedent and did not in fact exercise her power during the decedent's life. Under the last sentence of Section 811 (c) (3), the transfer is not taxable since possession or enjoyment of the property was obtainable during the decedent's life through the exercise of the wife's power which was a power of appointment as defined in Section 811 (f) (2) of the Internal Revenue Code, and was in fact exercisable immediately prior to the decedent's death.

Between these two extremes is the field for caution. Seemingly unimportant trust clauses deserve careful drafting to avoid having the trust corpus subjected to estate taxation on the basis of a theory not readily perceived. Often the clause may even be unessential to the grantor's purpose of setting up a trust for his children. Even careful and informed drafting can give no absolute assurance against new Congressional demands for revenue.

TRANSFERS PRIOR TO 1949

Let us try to distill from the 1949 amendment a few guide rules to map a course free from tax traps for our clients. First, let us say a word about pre-October 8, 1949 transfers taking effect at death. The Technical Changes Amendment prevents the application of the *Spiegel* case [9] to transfers made before October 8, 1949, the date upon which the Conference Committee agreed to the contents of the Technical Changes Act. In addition it limits application of *Helvering v. Hallock* and *Klein v. U. S.*[10] with respect to pre-October 8, 1949 transfers. The application of the *Spiegel* case is prevented as to transfers made before October 8, 1949 by the removal of possibilities of reverter by operation of law from consideration, as a ground for taxing irrevocable lifetime transfers. Therefore, if a transferor has in the past transferred property into an irrevocable trust and has provided for payment of remainders to his children or their issue after his death, the fact that if he should leave neither children nor grandchildren surviving him at the date of his death and that the property would return to his estate by operation of state law, will not alone make the transfer taxable if he is in fact survived by either children or grandchildren.

Application of the *Hallock* and *Klein* cases is also limited as to pre-October 8, 1949 transfers. In these cases it was provided that the express retention of a reversionary interest will not make a transfer taxable unless the value of the reversionary interest is worth more than five per cent of the value of the property transferred. The value of such reversionary interest is to be determined as of immediately before the death of the decedent.

EFFECT OF 1949 AMENDMENT

Second, let us consider the effect of the amendment on transfers made after October 8, 1949. The prospective influence of the amendment is to give full force and effect to the *Klein, Hallock* and *Spiegel* cases and to several others as well, for all future interests, i.e., those made after October 8, 1949. Let us spell this out. The prospective application of the amendment keeps and affirms the pre-existing rule that only when the death of the transferor is the operative factor ending his reversionary interest and conferring an interest in the estate on the beneficiary, does the property transferred become includible in the estate of the transferor. In addition, by abolishing the doctrine of *Reinecke v. Northern Trust Company,* an estate tax can be levied on a parent-transferor, even though the parent parted with *all his interest,* present and pros-

[9] Spiegel's Estate v. Commissioner, 335 U. S. 701 (1949).
[10] 283 U. S. 231 (1931).

pective, in the property. You recall the old estate tax regulation which established the test in determining whether a transfer is taxable as one intended to take effect at death. That test was contained in the requirement that "the decedent or his estate possesses any right or interest in the property (whether arising by the express terms of the instrument of transfer or otherwise)." In other words, under the prospective amendment, it is no longer necessary for the transferor to have even a reversionary interest. We now look only to the persons who are to receive the possession or enjoyment to determine whether or not the tax applies. If any person must survive the transferor to obtain possession or enjoyment, the interest passing to such person is taxable. There is one exception to this. The law specifically provides that there is no basis for taxing any interest of which possession or enjoyment could be obtained by any beneficiary during the decedent's life through the exercise of a power of appointment as defined in Section 811 (f) (2), which, in fact was exercisable immediately prior to the decedent's death. This has reference to transfers by the decedent under which he grants a power of appointment to others and makes it exercisable by them alone. This seems to overrule the decision of the Supreme Court of *Goldstone v. U. S.*[11]

We do not have time to consider specific trust provisions as to whether or not they will or will not be subjected to the Federal Estate Tax. In fairness to our life underwriter friends, let us point to a tax trap in their field. The 1949 amendment and its effect on intervivos gifts of life insurance must await the developing decisions of the Tax Court and the District Courts. But there are some decisions on the payment of life insurance premiums which point to a tax trap. You recall the cases holding that the payment of a premium on a policy by one other than the owner constitutes in part a gift of a part interest, and therefore does not come within the annual gift tax exclusion, except to the extent that such payment increases the cash surrender value.[12] These cases suggest the likelihood that the Commissioner will take the position that a gift of a policy by an insured (even it found not to be made in contemplation of death) may nevertheless be held to be, at least in part, a transfer taking effect at death, since to the extent that the proceeds exceed the cash surrender value, the possession and enjoyment of the gift can be obtained only by the donee surviving the decedent. Such a tax gathering construction of the Technical Changes Act certainly should not justify inclusion of more than the difference between the cash surrender value and the face amount of the policy. We all know that the donee has immediate possession and enjoyment of the cash surrender value. The Commissioner might well be successful in taxing the excess which comes into possession and enjoyment on the donor-insured's death.

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[11] 325 U. S. 687 (1945).

[12] Chittenden v. Hassett, District Court of Mass., 42-1 U.S.T.C. Para. 10,047.

FORMS OF BUSINESS ORGANIZATION AND ESTATE PLANNING

HOWARD E. PARKS*
of the Denver Bar

The treatment of closely-held businesses, whether the form be that of sole proprietorship, partnership or corporation, presents complex problems to the estate planner.

One of the first things for consideration is whether the present form of organization should be changed. This will involve a comparison of the income tax burden under the present form with the tax burden under the proposed form. With the existing excess profits tax, it is entirely possible that the form can be changed to advantage if it presently is a corporation, and consideration should be given to the possibility of converting into a sole proprietorship or partnership. In this connection, not only must the rate of taxes on current income be taken into consideration, but also capital gain or loss upon the dissolution of the corporation. Generally speaking, the formation of a corporation in lieu of a sole proprietorship or partnership, does not give rise to capital gain or loss problems.

For a number of reasons the estate planner's problems are eased when the organization is in the form of a corporation. There is less hesitancy in attempting to continue the business by reason, first, of the absence of individual liability, and, secondly, because its continuity of existence, regardless of the death of the stockholders, simplifies the transition upon death. The corporate form may give rise to tax economies during life and after death by virtue of the ability, through payment of salaries and rent and by not paying dividends, to make a division of the corporate income between the corporation and its stockholders so as to minimize the over-all tax. Failure to pay out profits as dividends should be in the light of Sec. 102 of the Internal Revenue Code, having to do with improper accumulation of surplus.

More often than not the man who has built up a business is reluctant to see the business terminated at or shortly after his death, but frequently he does not fully appreciate the extent to which he *is* the business. Before any serious consideration is given to plans for perpetuating the business, a careful survey should be made to determine whether there exists in the business, personnel which is probably capable of providing profitable management. If there are several individuals active in management, it is entirely possible that those remaining can carry on the business profitably, and it will not be necessary that the family of the one dying retire from participation in the profits of the business. It should be recognized from the outset, however, that conflicts are likely to arise between the non-working owners of a business and those whose personal efforts are producing the profits to be di-

* Vice President and Trust Officer of the Denver National Bank.

vided, and for that reason some suitable arrangement must be made to adjust the salaries or other withdrawals of the survivors to compensate for this factor. Accordingly, if it is desired that the business be carried on, the necessary arrangements should be made to assure capable management, and some satisfactory plan should be devised with that management for division of profits and compensation for services.

BUY AND SELL AGREEMENTS

In the event it appears desirable to retire the interest of the decedent, it is usually preferable to have a definite pre-arrangement among the interested parties. It is customary in such cases to enter into buy and sell agreements among the proprietors. These agreements may consist of an option in the survivor to buy the interest of the decedent. Such arrangements, of course, are unsatisfactory to the decedent's estate for the reason that there is no compulsion upon the survivors to exercise the option and the estate may own a proprietary interest with, perhaps, all of the problems of a minority owner. In any event there is no assurance under this plan that funds will be available for payment of death tax and expenses of administration. The parties may prefer to enter into a binding agreement whereby the survivors agree to buy the interest of the decedent, but, of course, they should be aware of the dangers inherent in a commitment to purchase at an indeterminate future time when circumstances might be such as to threaten the solvency of the survivors. Generally speaking, however, if proper funding arrangements are made, so that the funds will be available upon the death of the decedent to pay the bulk of the purchase price, the binding agreement is likely to be the most satisfactory solution.

Such agreements, whether options or binding agreements, should provide a method for fixing the purchase price. Customary provisions for this purpose are book value, a stated price agreed in advance, a stated price to be varied from time to time by periodic agreement, appraisal at death, or a formula frequently related to book value, plus an adjustment for good-will value. Obviously, the less flexible the method of determining the purchase price, the less likely it is that the price arrived at by it, will closely approximate true value.

One important consideration is to arrange, if possible, that the purchase price fixed shall be fully effective to determine the value of the business interest for Federal Estate Tax purposes. In the first place, if there is any element of gift between the proprietors, e.g., if there is some family or other relationship between them whereby they are not dealing at arms length with each other, the Federal Estate Tax examiner is quite likely to reject the purchase price fixed in the agreement as being binding upon him. Of course, the estate tax examiner must take into consideration the existence of an agreement, since its existence is a factor in arriving at fair market value,[1] but such arrangement as a first refusal

[1] Estate of Matthews, 3 T. C. 525 (Dec., 1944).

will not be conclusive, for the reason that there is no assurance that the survivors will exercise their right. In order for a price set forth in the buy and sell agreement to be controlling on the Federal government, it must impose an effective barrier to sale by the decedent during his lifetime at a greater price than that which would be effective on his death.[2] The Federal courts have held that if the decedent had the right to sell his interest, during his lifetime, free from the buy and sell agreement, the fair market value just before death is the proper figure to include in the gross estate.[3] The decedent's estate also must be compelled to sell under the agreement in order for the price under the agreement to be fully effective.[4] Since most state death taxes are on the right to receive, the state courts have tended to accord less significance to buy and sell agreements than the Federal courts.

Use of Life Insurance to Provide Funds

Having arrived at a plan for a buy and sell agreement which points the way to the price to be paid, and having arranged the agreement in such a way that it is reasonably sure to be controlling for tax purposes, the next important problem is how to make the funds available at the proper time.

Obviously, life insurance is the most satisfactory solution since its proceeds are available simultaneously with the event which gives rise to the need for the funds.

Who Should Pay the Premiums?

Having decided upon life insurance as the means for providing a part or all of the purchase price, the next question is how the premiums should be paid. If paid by a partnership, the partner may be indirectly paying a part of the premium on the policy on his own life so that a corresponding part of the policy would be includible in his gross estate for Federal Estate Tax purposes.[5] This would seem quite clearly to be true if the premiums are treated on the books of the partnership as an expense of doing business or as a reduction of profits before division. The partnership books could, of course, be kept so that it clearly appears that no part of any premiums on the policy on the life of a particular partner are paid from his interest in partnership earnings or capital, but that the only premiums he pays, directly or indirectly, are on policies on the lives of his partners.

Some think there is danger in having a corporation controlled by a single stockholder pay the premiums on a policy on his life, because the Commissioner might contend that for purposes of taxation the corporation is the stockholder's *alter ego,* hence he indirectly pays the premiums. In this event there is a possibility that both the policy and the stock would be included in the gross estate of the deceased stockholder. If the corporation pays the

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[2] Lamb v. Sugden, 82 F. 2d 166 (1936).
[3] Estate of Matthews, *op. cit.*
[4] Lamb v. Sugden, *op. cit.*
[5] Sec. 811(g), I. R. C.

premiums, and the payment of premiums is for the benefit of the stockholder's estate rather than for the benefit of the corporation, the payment may be construed as the payment of a dividend.

In order to avoid the problems just alluded to, the customary plan is for each of the proprietors to take out on the lives of his co-proprietors insurance policies and to pay the premiums on such policies. In this way, upon the death of the insured, the survivors receive the proceeds free from income tax,[6] and there is no danger that the proceeds of the policies will be included in the gross estate of the decedent.

DESIGNATION OF BENEFICIARY

The next step is to determine who shall be the beneficiary of the insurance. If the policies are payable to the corporation or partnership, the proceeds will tend to increase the value of the decedent's interest in the business, frequently necessitating the inclusion of both the proprietary interest and, indirectly, a part of the insurance in the gross estate. Arrangements are made frequently to have the policy paid to the corporation, which in turn agrees to retire the decedent's stock. In most states such retirement can take place only out of surplus, and if surplus is deficient or non-existent, the contract cannot be fulfilled. It has been held that a contract by the corporation to retire stock, regardless of the condition of its surplus, is void and that no rights flow from the contract.[7] In order to avoid this, there frequently is an agreement among the stockholders to cause the corporation to retire the stock. This agreement, of course, can be carried out only if the requisite surplus is available. There is also the danger, under certain circumstances, if only a part of a stockholder's stock is retired, that the transaction will be treated as a taxable dividend under Sec. 115(g) of the Internal Revenue Code. Congress, in 1950, amended this section to make it possible, in certain limited cases, to retire sufficient stock to pay inheritance and estate taxes without the transaction being treated as a dividend, but this relief provision fails to cover the situations of many proprietors.

Another objection to having the corporation retire the stock of the decedent is that it becomes treasury stock, and while the surviving stockholders have caused the corporation to pay premiums on the policy, yet the insurance proceeds are not reflected as a part of their basis for the stock retired. The effect of this stock retirement is to reduce the outstanding stock, and this enhances the value of the remaining stock with no corresponding increase in income tax basis; accordingly, there will be a larger capital gain tax upon sale by the survivors. If the transaction is handled entirely outside the corporation, the surviving stockholders will have as a basis the purchase price of the stock, which will be derived in part from insurance proceeds. It must be recognized, however, that in these days of high taxes it is sometimes

[6] Sec. 22(b)(1), I. R. C.

[7] Topeka, Loring & Schwartz, Inc. v. Schwartz, (N. Y.) 163 N. E. 735.

difficult, if not impossible, for the individual stockholders to provide, after individual income taxes, enough available personal funds to insure the lives of the co-proprietors in an amount sufficient to serve the purpose, and for that reason there is no other practical way than to cause the corporation to pay the premiums and be the beneficiary of the policies.

Frequently, an arrangement is made so that the policies on the life of each proprietor are made payable to his wife, or some other member of his family, with the agreement providing that the surviving proprietors will receive the interest of the deceased proprietor in the business. This method, while having the merit that policy options can be made available to the beneficiary simply, has the serious defect that the business interest of the deceased proprietor has never passed through the probate court and hence has never been subjected to the claims of creditors nor have the proceeds of the insurance been subjected to such claims. In the event the deceased proprietor is insolvent at death, his co-proprietors have acquired a doubtful right to his interest.

Occasionally, such policies are made payable to the surviving stockholder or partner as beneficiary. In this case, however, the survivor holds the insurance proceeds and is in control of the business interest. This plan has the defect that the creditors of the survivor may intervene, or his position of being in control of both the purchase price and the thing to be purchased may give rise to delay or litigation.

To avoid the difficulties outlined above, the generally preferred method of carrying out a stock purchase agreement is to have the policies on the lives of the proprietors (in each case the premiums being paid by the proprietors other than the insured proprietor) payable to, or assigned to, a neutral trustee. If the business organization is a corporation, the stock is likewise deposited with the trustee in negotiable form. The trustee holds both the stock and the insurance policies, and when a death occurs he collects the insurance and receives from the survivors the notes, or other consideration for the difference between the purchase price and the insurance. He then delivers the stock to the survivor and the insurance proceeds and the notes to the decedent's executor. Not only does this plan avoid the possibility of the decedent making a sale, pledge or gift in violation of the agreement (the possibility of which has much to do with the conclusiveness of the price for Federal Estate Tax purposes), but the proceeds of the sale are clearly subjected to the claims of creditors, and questions as to the title of the survivors to the decedent's interest are eliminated.

Partnerships and Sole Proprietorships

In event the organization is a partnership, the procedure would be much the same except that the trustee would deliver the insurance proceeds and other consideration to the executor upon receipt from the executor of a relinquishment of all claim to partnership assets, and deliver it to the survivor.

The sole proprietorship is the most difficult form of organization to deal with, whether it is to be sold or continued in existence. In a very large percentage of the cases liquidation is the only feasible solution because there are no key men in the business, or members of the family, capable of continuing it for any length of time. The executor named will not likely be willing to continue operation over an extended period of time, unless the business is also willed to him. If the operation of the business was a full-time job for the decedent, it is likely to be the same for his executor. In certain cases there will be key men in the business who are capable of continuing its profitable management. In such case, consideration should be given to a buy and sell agreement with the key men, funded by life insurance. In some cases the net cost to the employer of increasing salaries sufficiently to pay premiums may not be prohibitive, after taking into consideration the owner's income taxes. In many cases the sole proprietorship could be converted into a partnership with the key men and the usual buy and sell agreement used. Unless some arrangement is made for a buy and sell agreement, then liquidation or sale of the sole proprietorship by the executor appears the only alternative. If so, the will should contain an adequate provision authorizing the executor to continue the business at the risk of the estate until such time as sale or liquidation to advantage can take place. If the business is likely to be continued for any length of time, there should be a specific provision in the will authorizing the executor to change the form of organization so that the business may be operated from time to time under any of the three recognized forms of organization.

It is obvious from the numerous questions touched upon, the problems in estate planning respecting the sole proprietorship or closely-held business interest are difficult. Many times it turns out that there is no really satisfactory solution which will adequately carry out the wishes of the owner. If a satisfactory solution is to be reached, it is most likely to be reached when a team consisting of lawyer, accountant, life underwriter and trust officer approach it together. It is quite possible that the trust officer may make a substantial contribution to the efforts of the team, because he has probably administered a very large proportion of the various plans which may be proposed, and his practical experience may shed considerable light upon the feasibility of any particular proposal.

BAR PRIMARY

The members of the Denver Bar Association were polled as to the qualifications of those who had announced their candidacies for judicial office on May 23, 1952. As a result of this primary, the Denver Bar Association endorses and urges your support of Philip B. Gilliam for Juvenile Court Judge, David Brofman for County Judge and Albert Frantz for District Judge.

CASE COMMENTS

MINING OPERATIONS—LATERAL SUPPORT FOR ADJOINING BUILDINGS (COLO FUEL AND IRON CORP. v. SALARDINO).[1]—Plaintiffs Salardino brought an action against C. F. & I. to recover for damages to improvements on lands owned by plaintiffs. It was alleged that as a result of the mining by the defendant of coal deposits, owned by defendant, under or adjacent to plaintiffs' land, said land subsided and that the improvements thereon were thereby damaged in the amount of $7,500. By amended complaint, the amount was raised to $15,000.

The complaint alleged that the defendant had done its mining in "a careless, wrongful and negligent manner." To this allegation defendant answered with a specific denial of negligence, and with two affirmative defenses, neither of which seems to have been decisive.

The evidence showed that defendant had mined its deposits at a depth of about 80 feet, and that the workings were in the vicinity of plaintiffs' lot lines extended vertically. The evidence also showed that plaintiffs' land had subsided, and that as a result thereof plaintiffs' improvements, including a building, were damaged. There was no direct evidence showing damage to plaintiffs' land in its natural state; all the evidence was introduced with reference to damage to plaintiffs' improvements.

Defendants filed a motion for a new trial on the grounds, in part, that: (1) there was insufficient evidence of negligence to allow the case to go to the jury, and failure to direct a verdict for that reason; (12) the instruction which fixed the liability of the defendant as absolute; and (3) defendant's instructions tendered and refused. The motion was denied, and defendant appealed from the judgment for the plaintiffs.

The Supreme Court determined only the specifications of points which related to the instructions given by the trial court. These instructions were based upon a theory of absolute liability resting upon defendant corporation for damage sustained by plaintiffs' *building* as a result of defendant's mining operation. The Supreme Court held that in order for plaintiffs to recover for damage to improvements, it was necessary for them to prove negligence and that therefore it was reversible error for the trial court to fail to instruct the jury to that effect.

There is probably no Colorado case directly in point. Neither the Supreme Court (apparently) nor the writer has been able to discover any Colorado decision decisive of the issues here involved. In the reported case are a few Colorado cititations which, while

[1] Colorado Fuel and Iron Corp. v. Salardino, ... Colo. ......, ... P. ...... (1952); 1951-52 C. B. A. Adv. Sh. No. 27, p. 367.

not directly in point, serve to illustrate the distinction in the law upon which this case was decided.

It seems to be well settled in Colorado that landowners are under an absolute duty to conduct their mining operations in such a manner that adjoining property will not be damaged.[2] However, this duty extends only to such damage as may occur to adjoining property in its natural state.[3] The duty may be avoided, apparently, by the creation between the parties of a contract, express or implied, by which the adjoining property owner waives his right to support of his property.[4] There seems to have been no such contract here.

One Colorado case, cited by the court, lends to the present decision some color of precedence, although it is by way of dictum.[5] In this case plaintiff's property was damaged by the subsidence of his land. The subsidence was caused by the mining of coal underneath plaintiff's land, the mining being done by defendant's lessee. Defendant had known of its lessee's negligent mining, and defendant had made use of the fruit of the operations. Plaintiff's improvements were damaged, and judgment for defendant was reversed on the theory of negligence. This is a departure from the theory of absolute liability which applies to damage to the land in its natural state, as laid down in the *Evans* case. However, the Supreme Court, in the instant case, relied primarily on foreign case law and text law in reaching its decision.

In a Montana case, *Neyman v. Pincus*,[6] the court, in discussing the distinction between the duty of an excavating landowner to provide lateral support for adjoining land and his duty to provide support for buildings and improvements upon adjoining land, said that the natural right of support extends only to the land itself and not to buildings placed on the land. In Michigan it has been held that the duty which rests upon an excavating owner to protect buildings on adjoining property is that of the exercise of ordinary care.[7] The general rule, therefore, at least outside Colorado, seems to be that expressed by the cases cited by the Supreme Court: The duty of support of buildings is one of ordinary care, and negligence must be the basis of an action brought for damage to buildings and improvements resulting from such excavations. For a general discussion of the rule see 2 C. J. S., p. 6, *et seq.*, and cases cited.

Applying this rule to the case in hand, it is fairly clear that the instructions of the trial court were substantially in error. The error was one of omission rather than commission. The court failed, in its instructions, to present to the jury the issue of negli-

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[2] Evans Fuel Co. v. Leyda, 77 Colo. 356, 236 P. 1023 (1925).

[3] Kirchof v. Sheets, 118 Colo. 244, 194 P. 2d 320 (1948); Evans Fuel Co. v. Leyda, *supra* note 2.

[4] Campbell v. Louisville Mining Co., 39 Colo. 379, 89 P. 767 (1907).

[5] *Id.* at 380.

[6] 83 Mont. 467, 267 P. 805 (1928).

[7] Horowitz v. Blay, 193 Mich. 493, 160 N. W. 438 (1916).

gence. The court required the jury to find for the plaintiffs if it found that the damage to plaintiffs' building resulted from the subsidence of plaintiffs' land caused by defendant's excavations. Although negligence was alleged by plaintiffs, and although apparently there was substantial evidence showing negligence, the trial court effectively negated all this work by its instructions, which placed defendant's liability for damage to the building upon the grounds of absolute liability. How often, cry the losers, is such the fate of the hard working trial attorney!

An interesting sidelight is brought out in the report of this case. It has little to do with the issues involved, but it should stand as another of the oft-repeated warnings to trial attorneys to remember that the justices of the Supreme Court are neither present at the trial, nor are they mind-readers, and that as a result of these perhaps unfortunate circumstances, a clear, accurate, and adequate record must be made for appeal purposes. In this case there was only one map of defendant's underground workings presented on appeal. In 19 pages of the record are printed witness' testimony with regard to locations on the map. The words "here" or "there" appear in the record more than 80 times. In no instance was there any indication in the record of the places or locations on the map to which "here" or "there" referred. As a result, to use the language of the Supreme Court, the map was "wholly useless" on review. The map, and the testimony in reference to it, and all the work that had been done preparing the exhibit were largely wasted, because of the failure of the attorneys who attempted to use the map and relative testimony to indicate in the record the places to which reference was made. Whether or not the failure of this exhibit to be of any use on review made any difference in the outcome of the case is uncertain. But whether it did or not, the fact that this effort was wasted, and the fact that the effect, if any, of the exhibit was wholly lost upon review, should serve to caution others against making the same kind of mistake.

WANTLAND L. SANDEL, JR.